NANYANG INSURANCE CO. (M) BHD.

v.

CHIN KIM HIN & ANOR.

HIGH COURT BORNEO
HAIDAR MOHD. NOOR J
[SUIT NO. KG. 118 OF 1990]
19 SEPTEMBER 1991

CONTRACT: *Construction contract - Performance guarantee issued by plaintiff who was not a party to the project - In favour of Government of Malaysia - Project terminated by Government of Malaysia - Plaintiff makes payment as demanded to the Government of Malaysia - Indemnity - Whether contract prematurely terminated - Arbitration.*

CONTRACT: *Whether conditional performance guarantee or on demand performance guarantee - Construction of material clauses of the performance guarantee - Whether condition precedent - Pleadings did not state conditional performance guarantee as a defence - Rules of the High Court 1980, O. 14 r. 1, O. 18 r. 19.*

This is an appeal by the plaintiff against the decision of the learned Registrar of the High Court dismissing the plaintiff's application under O. 14 r. 1 and/or O. 18 r. 19 of the Rules of the High Court 1980 (RHC). The plaintiff's application was dismissed *inter alia* on the ground that the said performance guarantee was a conditional guarantee.

The only issue before the Court was in respect of the performance guarantee entered into between the plaintiff and the Government of Malaysia at the request of the first defendant. The undisputed facts of the case were that the first defendant had entered into a road construction contract with the Government of Malaysia on or about 5 September 1988. At the request of the first defendant, the plaintiff issued a performance guarantee in favour of the Government of Malaysia in the sum of RM722,715.80 on or about 5 September 1988. The first defendant in turn executed a letter of indemnity dated 5 September 1988 in favour of the plaintiff. The Government of Malaysia subsequently made a demand on the performance guarantee on the ground that the construction contract was terminated by the Government of Malaysia and the plaintiff had guaranteed for the due performance of the construction contract by the first defendant.

After making the payments as demanded, the plaintiff issued a letter of demand to the first defendant for indemnification to it of the amount paid to the Government of Malaysia under the performance guarantee.

The defendant's contention was that he had not committed any breach of the construction contract and that the Government of Malaysia had prematurely terminated the construction contract and claimed that he had been relieved from the performance of the contract. It was further contended that the plaintiff should not pay the sum guaranteed under the performance guarantee to the Government of Malaysia, as the first defendant would be taking the necessary action against the Government of Malaysia under the construction contract.

The issue before the Court was whether the performance guaranteed is a conditional one or otherwise.

Held:

[1] The pleadings did not expressly plead conditional performance guarantee as a defence. As the parties are bound by their pleadings, it is open to the first defendant to rely on conditional performance guarantee as a ground to resist the application of the plaintiff.

[2] Clause 2(2) clearly indicated that it is an on demand performance guarantee and any dispute between the first defendant and the Government of Malaysia must be settled by themselves and has nothing to do with the plaintiff. By virtue of the letter of indemnity executed by the first defendant in favour of the plaintiff for the execution of the performance guarantee by the plaintiff in favour of the Government of Malaysia, the first defendant has no defence and the plaintiff should accordingly succeed in its O. 14 application.

[Plaintiff's application allowed with costs.]

Cases referred to:

Syarikat Perumahan Pegawai Kerajaan Sdn. Bhd. v. Bank Bumiputra Malaysia Sdn. Bhd. [1991] 2 MLJ 568 ***(cit)***

Edward Owen Engineering Ltd. v. Barclays Bank [1978] 1 QB ***(foll)***

Malayan United Bank Bhd. v. Straits Central Agencies (Sarawak) Sdn. Bhd. & Anor. [1990] 2 MLJ 254 ***(foll)***

Legislation referred to:

Rules of the High Court 1980, O. 14 r. 1, O. 18 r. 19

For the plaintiff - Y.Y.Sim; M/s. Tang Teng & Partners
For the defendant - William Chang; M/s. Yong & Co.

JUDGMENT

Haidar Mohd. Noor J:

This is an appeal by the plaintiff against the decision of the learned Registrar of the High Court dismissing the plaintiff's application under O. 14 r. 1 and/or O. 18 r. 19 of the Rules of the High Court 1980 ('RHC').

From the written ruling of the learned Registrar, it would appear that the plaintiff's application was dismissed with costs on two grounds, namely:

1. The affidavit filed in support of the application has not complied with the requirements of RHC in that the affidavit did not state the deponent's belief that there is no defence to the claim filed.
2. The performance guarantee is a conditional performance guarantee.

It is observed that ground I was not raised by the Counsel for the first defendant before the learned Registrar. Be that as it may, if the learned Registrar had perused carefully the affidavit of Y.Y.Sim in support of the plaintiff's application, it is very clear that by para. 2 thereof, the requirements of RHC had been duly complied with the therefore she had, with respect, erred in her decision on this ground. Para. 2 reads:

> I verily belief that the 1st defendant has no defence or no *bona fide* defence to this action ...

The only issue for consideration is in respect of the performance guarantee entered into between the plaintiff and the Government of Malaysia at the request of the first defendant.

The Undisputed Facts

(a) The first defendant entered into a road construction contract (Exh. 'CKH2') with the Government of Malaysia on or about 5 September 1988.

(b) At the request of the first defendant, the plaintiff issued a Gerenti Perlaksanaan (performance guarantee) in favour of the Government of Malaysia in the sum of RM722,715.80 on or about 5 September 1988. The performance guarantee is exhibited as 'SYY1A' to the supplementary affidavit of Y.Y.Sim (encl. 14).

(c) The first defendant in turn executed a letter of indemnity dated 5 September 1988 (Exh. 'SYY2') in favour of the plaintiff.

(d) The Government of Malaysia subsequently made a demand on the performance guarantee on the ground that the construction contract was terminated by the Government of Malaysia (Exhs. 'SYY3' and 'SYY4') and the plaintiff had guaranteed for the due performance of the construction contract by the first defendant.

(e) The plaintiff, after making payments as demanded through its advocate, M/s. Tang Teng & Partners issued a letter of demand dated 4 April 1990 (Exh. 'SYY4') demanding the first defendant to idemnify it of the amount paid to the Government of Malaysia under the performance guarantee.

The first defendant, however, contended that he had not committed any breach of the construction contract and that the Government of Malaysia had prematurely terminated the construction contract and therefore claimed that he had been relieved from the performance of the contract. The first defendant therefore contended that the plaintiff should not pay the sum guaranteed under the performance guarantee to the Government of Malaysia (see Exhs. 'CKH5', 'CKH6' and CKH 7') as the first defendant would be taking the necessary action against the Government of Malaysia under the construction contract.

Now, in construing whether the performance guarantee is a conditional one or otherwise, Clause 2(2) is relevant. Clause 2(2) reads:

> Penggerenti akan membayar gantirugi kepada kerajaan sebanyak dan setakat RM722,715.80 (Ringgit Seven Hundred and Twenty-two Thousand Seven Hundred and Fifteen and cents Eighty only) dalam tempuh tiga bulan selepas menerima satu notis bertulis menghendaki penggerenti membayar kepada kerajaan apa-apa pelanggaran oleh kontraktor terhadap kewajipannya di bawah kontrak dengan sentiasa tertakluk bahawa segala apa-apa amaun wang bayaran oleh penggerenti tidak melebihi had yang disebutkan dalam perenggan ini.

Mr. Chang, Counsel for the first defendant contended that the performance guarantee is not a demand performance guarantee. He argued that it is a **conditional** performance guarantee and relied on Clause 2(1) of the performance guarantee which reads:

> Jika kontraktor (melainkan ia dilepaskan daripada melaksanakan kontrak menurut sesuatu fasal kontrak atau menurut statut atau menurut keputusan sesuatu tribunal yang mempunyai bidangkuasa yang layak) mungkir melaksanakan kontrak mengenai apa-apa perkara atau melaksanakan apa-apa pelanggaran terhadap kewajipannya dibawah kontrak, maka kerajaan, akan jika perlu, memberi penggerenti peluang untuk berbincang sebelum sesuatu keputusan dibuat.

With respect, I do not see how it can be argued by Mr. Chang that Clause 2(1) is a condition precedent in the guarantee and that all other clauses must be read subject to it. My understanding of Clause 2(1) is that unless the first defendant is released from the performance of the construction contract by the Government of Malaysia or by statute or by a decision of a tribunal only then will the plaintiff be not obliged to pay the guaranteed sum to the Government of Malaysia. In the present case the Government of Malaysia has not released the first defendant from the performance of the construction contract but instead the construction contract was terminated by the Government of Malaysia on account of alleged breach of it by the first defendant (Exhs. 'SYY3' and CKH3'). There is no evidence

of any release of the construction contract under any statute and also there has been no decision made by any tribunal except that the termination of the construction contract will be referred to arbitration by the first defendant. Even if the disputes are referred to arbitration, the payment of the guarantee cannot be stayed pending the arbitration (see *Syarikat Perumahan Pegawai Kerajaan Sdn. Bhd. v. Bank Bumiputra Malaysia Sdn. Bhd.* [1991] 2 MLJ p. 568). Further, Clause 2(1) gives a discretion to the Government of Malaysia to discuss with the plaintiff before taking action on the performance guarantee in the event the first defendant did not fulfil the construction contract. This provision has got nothing to do with the first defendant. Therefore, there are no merits in the argument of Mr. Chang that the performance guarantee is a conditional performance guarantee. In any event, from an examination of the pleadings it would seem clear that the first defendant did not expressly plead conditional performance guarantee as a defence. It is trite law that the parties are bound by their pleadings and as such it is not open to the first defendant to rely on conditional performance guarantee as a ground to resist the application of the plaintiff.

In my view, Clause 2(2) clearly indicates that it is an on demand performance guarantee. In this respect, Lord Denning in *Edward Owen Engineering Ltd. v. Barclays Bank* [1978] 1 QB at p. 171, said:

> A performance bond is a new creature so for as we are concerned. It has many similarities to a letter of credit, with which of course we are very familiar. It has been long established that when a letter of credit is issued and confirmed by a bank, the bank must pay it if the documents are in order and the terms of the credit are satisfied. **Any dispute between buyer and seller must be settled between themselves.** The bank must honour the credit ...
>
> All this leads to the conclusion that the performance guarantee stands on a similar footing to a letter of credit. *A bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relations between the supplier and the customer; nor with the question whether the supplier has performed his contractual obligation or not; nor with the question whether the supplier is in default or not. The bank must pay according to its guarantee, on demand, if so stipulated, without proof or conditions.* The only exception is when there is clear fraud of which the bank has notice.
> (Emphasis supplied)

In this case there is no allegation of fraud. Therefore by the terms of Clause 2(2) once a demand in writing is made by the Government of Malaysia (Exhs. 'SYY3' and 'SYY4') the plaintiff must pay "without proof or conditions" as per *Lord Denning in Edward Owen Engineering Ltd.'s* case and any dispute between the first defendant and the Government of Malaysia must be settled by themselves and has nothing to do with the plaintiff. By virtue of the letter of indemnity dated 5 September 1988 executed by the first defendant in favour of the plaintiff (Exh. 'SYY2') for the execution of the performance guarantee by the plaintiff in favour of the Government of Malaysia, clearly, in my view, the first defendant has no defence in this case and the plaintiff should accordingly succeed in its O. 14 application.

In respect of the other procedural issues not affecting jurisdiction raised by the first defendant I do not propose to deal with them as such issues were not raised before the learned Registrar (see *Malayan United Bank Bhd. v. Straits Central Agencies (Sarawak) Sdn. Bhd. & Anor.* [1990] 2 MLJ 254).

In the circumstances, I allowed the appeal of the plaintiff and accordingly granted the O. 14 application with costs.

Also found at [1992] 1 CLJ 454